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An international business transaction is a transaction between two or more countries that includes international trade in goods, international trade in services, financial transactions, foreign investment, overseas construction, etc.

Companies engage in international business transactions for various purposes. Maximizing corporate value by increasing revenues and profits will be the ultimate goal for most companies. Companies engaging in international business transactions are likely to gain more revenues and profits.

For the successful completion of an international business transaction, depending on the terms of the transaction, both parties need access to funds. Small- and medium-sized enterprises (SMEs), compared to large companies, often face difficulties in raising capital or funds. Financing an international business transaction is often key to successful completion.

There are various financing mechanisms available for international business transactions. Besides financing ability, the choice of a proper financing mechanism is also important to the success of an international business transaction.

For successful completion of an international trade in goods or services, depending on the payment terms and other conditions of a particular transaction, both exporters and importers need access to funds. Thus, it is important to understand trade finance mechanisms for a successful outcome of international trade. For credit terms transactions (or for long payment terms transactions), exporters need trade finance, whereas for cash terms transactions (or for a payment in advance transactions), importers need trade finance. The ability to allow longer payment terms has become a competitive factor in an international trade. Long payment terms bring a cash flow shortage to an exporter, thereby making it important for an exporter to have trade finance. Thus, an exporter needs to obtain trade finance in order to make up the cash flow shortage arising out of an international trade transaction with long credit terms (or long payment terms).

Exporters preparing the performance of export transactions are frequently in need of finance for the performance of the transactions (or for delivery of the goods). Such finance is called pre-shipment finance.
Exporters are also in need of finance after the performance of the transactions (or after delivery of the goods) because they get paid long after transactions are completed. Such finance is called post-shipment finance. Post-shipment finance includes the negotiation of bills of exchange and/or documents, forfaiting, and factoring.

Export credit insurance (or export credit guarantee) is very useful for the facilitation of pre-shipment finance and of post-shipment finance. Therefore, export credit insurance (or export credit guarantee) is considered as one of the financing mechanisms available in international trades.

An overseas construction project helps exporting countries to get access to new emerging markets and to promote economic cooperation with an importing country. Such benefits encourage countries to enhance competitiveness in overseas construction activities. An overseas construction project is normally huge and complex. Also it typically requires long-term financing as the amount of time it takes for an overseas construction project to pay for itself is considerably long.

As an overseas construction project requires considerable amounts of capital investment, an employer (or an owner), particularly if they are in a developing country, cannot afford to finance the undertaking using their own resources. Thus, an employer (or an owner) normally requires a financing mechanism, which is to be provided by a contractor. Therefore, the financing mechanism for an overseas construction project is conclusive in winning it.

There are various financing mechanisms available for an overseas construction project, some of which are combined. Some major financing mechanisms for overseas construction projects include supplier credit/buyer credit, project finance, export credit insurance (or export credit guarantee), syndicated loans, independent guarantees (or demand guarantees, standby letters of credit), official development assistance (ODA), etc. A detailed understanding of financing mechanisms is often a key to success in overseas construction projects.

Many countries have established export credit agencies to promote exports through various supports including export credit insurance (or export credit guarantee). The main aim of export credit insurance (or export credit guarantee) is to promote their exports by protecting exporters from the commercial risks of importers, and from the political risks of a importing country. Export credit insurance (or export credit guarantee) basically provides protection against the non-payment risk, and it covers both political risks, as well as commercial risks.

Export credit insurance (or export credit guarantee) promotes a country's exports by giving a variety of advantages to its exporters. The key functions
of export credit insurance include reducing non-payment risks, offering competitive payment terms, increasing exports with reduced non-payment risk and competitive payment terms, creating easy and accessible trade financing solutions, etc. When an export credit insurance (or export credit guarantee) backs an exporter's foreign receivables, commercial banks are often willing to lend to an exporter with favorable terms against foreign receivables, otherwise excluded from the borrowing base.
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1. Overview of international business transactions

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International Business

International Business

A Basic Guide to Exporting
Chapter 1

2. Characteristics of international business transactions

Regardless of the purposes of international business transactions, companies must be aware of the characteristics of an international business transaction,
and must understand the distinctions between an international business transaction and a domestic business transaction. These characteristics of an international business transaction bring companies engaging in international business transactions risks as well as benefits. Therefore, it is necessary to maximize the benefits and minimize the risks to achieve business purposes in international business transactions. An understanding of the characteristics of international business transactions will be the starting point for companies engaging in international business transactions.

2.1 Different languages

As an international business transaction is a transaction between two or more countries, the languages will normally differ between the parties. English is commonly used in international business transactions, and correspondence and documents are normally made in English.

2.2 Different currencies

As an international business transaction is a transaction between two or more countries, the currencies will normally differ between the parties. In an international business transaction, hard currencies (such as the U.S. Dollar, Euro currency, British Sterling, or Japanese Yen) are normally used. A transaction with soft currency can be a problem for the other party.

2.3 Different laws and standards

As an international business transaction is a transaction between two or more countries, laws will differ between the parties. Industry standards will also differ between the parties. Every authority applies particular laws and standards to a specific instance. A court normally uses a “choice of law rules” to determine the laws applicable to a dispute. When a German exporter enters into a contract for the sale of automobiles with an American importer, we need to decide which law governs the contract.

Charles W.L. Hill, et al., at 530.

Choice of law rules are normally enacted in “international private law” of each nation.


*International Business Law,*
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4 (American law or German law, sometimes a third country’s law). The law governing a contract or legal matters is called the “governing law” or the “applicable law”.

In reality, American law differs from German law. No matter which country’s law governs a contract for the sale of automobiles between a German exporter and an American importer, American laws and standards for automobile safety will apply to the automobiles driven in America. Therefore, the automobiles for American import should be manufactured in compliance with the American laws and standards.

Prior to exporting to a foreign country, an exporting company should be aware of any law of an importing country that might affect the export transaction. Basic information on that law can often be obtained from an importing company or a distributor in an importing country, but further detailed and specific information can be obtained by legal opinions from a local lawyer.

2.4 Different customs

As an international business transaction is a transaction between two or more countries, customs will differ between the parties. Customs may apply to an international business transaction as a gap-filling of the laws. Customs will differ country to country and region to region. An exporting company should be aware of the customs of an importing country for the successful completion of a transaction.

2.5 Different culture

As an international business transaction is a transaction between two or more countries, culture will differ between the parties. An international business transaction involves parties in different countries and in different cultures. Cultural difference might bring misunderstanding and an adverse effect to a transaction. In order to complete an international business transaction successfully, we should understand the culture of a foreign party.

2.6 Long distance

As an international business transaction is a transaction between two or more countries, the parties are located at long distance. It will take time for the parties to meet in one place for the negotiation of a transaction.
2.7 Government control and intervention

As an international business transaction is a transaction between two or more countries, it gives a material effect on national interest as well. Thus, the government has a tendency to intervene in and have control over international business transactions.

As the goods move across national boundaries in an international trade in goods, each country controls and inspects the goods and transportation. Some of the purposes of such control are to protect the local economy, national health (i.e., Ebola virus infection, or MERS infection), etc. An export declaration is required in an exporting country, and an import declaration is required in an importing country.

Transactions with foreign governments, government agencies, or public entities often require specialized procedures and documentations (i.e., public competitive bidding, compliance with invitation to bidding, bank guarantees, numerous certifications, etc.). In many countries, imports by the government exempt import licenses, or customs duties.

2.8 Complex documents

As an international business transaction is a transaction between two or more countries, complex documents are required. In an international trade in goods, various documents (i.e., bill of lading, airway bill, certificate of origin, packing list, inspection certificate, marine insurance policy, etc.) are required. Unlike an international trade in goods, many of these documents are not normally required in a domestic trade.

Furthermore, either an exporter or an importer in an international trade in goods, concludes incidental contracts with a shipping company, an insurance company, an inspecting company, banks, etc. Therefore, an international trade in goods involves various contracts and documents other than a contract for the sale of goods.

3. Financing international business transactions
Chapter 1

Companies, often face difficulties in raising capital or funds. Financing an international business transaction is often key to successful completion. There are various financing mechanisms available for international business transactions. Besides financing ability, the choice of a proper financing mechanism is also important to the success of an international business transaction.

As a large volume of funds is required in a huge international business transaction such as an overseas construction, a plant construction, a natural resources development project, etc., the financing procedure for such a transaction is normally complex. Governments often intervene in and exercise influence on it.

In an international sale of goods, both an exporter and an importer seek trade finance depending on the terms and conditions of the transaction. In a credit terms transaction (or in a long payment terms transaction), an exporter will need trade finance, while in a cash payment terms transaction (or in an advance payment terms transaction), an importer will need trade finance. The ability for an exporter to allow long payment terms has become a key competitive factor in an international trade. However, long payment terms normally bring a cash flow shortage to an exporter. Thus, an exporter needs to obtain trade finance in order to make up the cash flow shortage arising out of an international trade transaction with credit terms (or long payment terms).

An exporter preparing for the performance of an export transaction is frequently in need of finance for the performance of a transaction (or for delivery of the goods), and such finance is called "pre-shipment finance". An exporter is also in need of finance after the performance of a transaction (or after delivery of the goods) because they get paid long after the performance of a transaction (or delivery of the goods), and such finance is called "post-shipment finance". Post-shipment finance includes the negotiation of bills of exchange and/or documents (or discounting receivables), factoring, forfaiting, etc.

The term of trade finance covers pre-shipment finance and post-shipment finance. Trade finance is generally secured by receivables and/or securities such as bills of exchange, promissory notes, cargo insurances, etc.
Introduction

Export credit insurances, letters of credit, payment guarantees, etc. The payment from the underlying international transaction will first be used for repayment of any outstanding trade finance loan. Thus, trade finance is considered more secured for a financing bank. Many countries operate export credit insurance (or export credit guarantee) programs for their national exports, and export credit insurance (or export credit guarantee) programs are very useful for the facilitation both of pre-shipment finance and of post-shipment finance. Therefore, export credit insurance (or export credit guarantee) is considered as a useful financing mechanism in international trades.

The working capital cycle is very important for cash flow management. The longer the working capital cycle, the longer a business is tying up capital in its working capital without earning a return on it. The working capital cycle mainly depends on the terms of payment in an international trade transaction. The working capital cycle in an international trade is normally longer than that in a domestic transaction. Therefore, exporting companies strive to reduce working capital cycles by collecting receivables quicker. Exporting companies may be able to shorten the working capital cycle with favorable payment terms. If the working capital cycle is shorter, a company can create more sales and revenues. Every company pursues a shorter working capital cycle through favorable payment terms and choosing a proper financing mechanism.

In making a trade financing decision, companies have to consider: the need for finance, the length of time for finance, the cost of different financing mechanisms, the risks associated with the financing, the need for pre-shipment financing, the need for post-shipment financing, etc.

An overseas construction project (or a plant construction project) is normally huge and thus requires considerable amounts of funds. An employer (or an owner), particularly if they are in a developing country, faces difficulty in financing the funds out of their own resources. Thus, an employer (or an owner) normally requires that financing should be provided by a contractor. Therefore, the proper financing mechanism for an overseas construction project is conclusive in winning the project. This is the primary reason we need to study financing mechanisms for an overseas construction project.

There are various financing mechanisms available for an overseas construction project (or a plant construction project), some of which are combined. The major financing mechanisms used for an overseas construction project are a supplier credit, a buyer credit, project finance, 11 US Commercial Services, at 169-170.
Chapter 1

8 export credit insurance (or export credit guarantee), syndicated loans, independent guarantees (or demand guarantees, standby letters of credit), official development assistance (ODA), etc. The precise understanding of each financing mechanism will be the key to success in an overseas construction project (or a plant construction project).

Many countries operate export credit insurance (or export credit guarantee) programs for their construction companies participating in overseas construction projects (or plant construction projects). An export credit insurance (or export credit guarantee) program can be used as a security for the loan in an overseas construction project (or a plant construction project). Export credit insurance (or export credit guarantee) is often a key to winning an overseas construction project (or a plant construction project).

Many countries have established export credit agencies (ECAs) to promote exports through various supports including export credit insurance (or export credit guarantee). There are various types of export credit insurance (or export credit guarantee) programs available for international business transactions. The terms of a specific export credit insurance (or export credit guarantee) differ from ECA to ECA, although basic concepts are similar. Even in one international business transaction, more than one type of export credit insurance (or export credit guarantee) program can be used either in combination or separately. Understanding various types of export credit insurance (or export credit guarantee) programs will be very useful for financing as well as for non-payment risk protection.

12 Many countries established some form of an Export-Import Bank to facilitate their exports. (Charles W.L. Hill, et al., at 541.)


1. Introduction

An exporter is normally concerned about payment, whilst an importer is normally concerned about delivery of goods. However, even a seemingly simple international trade transaction can go wrong, and sometimes it really goes wrong. There are various reasons why a transaction goes wrong. Absence of risk assessment or wrong risk assessment would be one of the most direct reasons for that. What is the best action that a company can take? The right risk assessment can minimize the risks. When the risk factors in a particular transaction are not acceptable, a company has to find another transaction.

While risk is a factor in all business transactions, international business transactions involve additional risks.\(^{15}\) An international business transaction involves more risk factors than a domestic business transaction. Most of the characteristics of an international business transaction bring some risks. Before commencing an international business transaction, a company must first consider various risks to which it will be exposed, and must assess the various risks.

Many of the risks will be the same regardless of whether we are exporting or importing. The main risk factors in an international business transaction include different languages, different currencies, different laws and standards, different customs, different culture, long distance, government control and intervention, complex documents, and finance concern.

\(^{15}\) Guillermo C. Jimenez, ICC Guide to Export/Import: Global Standards for International Trade,
2. Risk factors

2.1 Different languages

As an international business transaction is a transaction between two or more countries, the languages will normally differ between the parties. The difference of language brings some risks to the parties. English is commonly used in international business transactions, and correspondences and documents are normally made in English. Whilst English is considered the standard language of international trade, its use is not universal and the level of understanding will vary from country to country and business to business. Although English is the standard language in international business transactions, disputes may arise out of English communication or documents.

2.2 Different currencies

As an international business transaction is a transaction between two or more countries, the currencies differ between the parties. If payment is going to be made in a currency other than that in which an exporter incurs their costs, currency risk (or foreign exchange risk) will arise. Currency risk (or foreign exchange risk) is present in all international transactions, and the size of that risk will depend on the currency and the outstanding period to full performance and payment. The exporter's main costs will normally be paid in their own national currency, which automatically creates currency risk if an export contract is concluded in a foreign currency. The choice of currency could be of great importance, particularly in an increasingly competitive market. Fluctuation of the exchange rate might bring unexpected loss or profit, which will bring significant risk in international business transactions. Foreign exchange and currency risks may give huge damages to a company, and result in actual monetary loss. In some cases, the choice of currency for a contract is more important than the contract price (or unit price). A movement in the foreign exchange rate creates unexpected losses or profits in a transaction. Still worse, some countries may impose a restriction on foreign currency exchange, or on foreign currency transfer, which will cause bigger risks and damages. Indeed, a number of countries have imposed restrictions on foreign currency exchange or transfer. In an international business transaction, hard currencies (such as the US Dollar, Euro currency, British Sterling, or Japanese Yen) are normally used. However, a transaction with soft currency can be a bigger problem.
2.3 Different laws and standards

2.4 Different customs

2.5 Different culture
2.6 Long distance

2.7 Government control and intervention
2.8 Complex documents

2.9 Finance concern
3. Commercial risk, country risk, and exchange risk

3.1 Commercial risk

- An importer cannot make payment due to insolvency, or bankruptcy.
- An importer raises a market claim (or a malicious claim) regardless of the quality of the goods.
- An importer delays payment due to a cash flow shortage.

Typical commercial risk to an importer is:
- An exporter delivers non-conforming goods.
- An exporter does not deliver the goods at all.
- An exporter delivers the goods behind schedule.

In order to mitigate commercial risk, we need to conduct a thorough credit investigation and evaluate the creditworthiness of the other party. Some risks can be reduced by obtaining favorable terms of a contract. Unfortunately, we give up other terms in return for obtaining favorable terms, as the terms of a contract are normally a zero-sum game. Export credit insurance (or export credit guarantee) is mainly designed for non-payment risk. Thus, export credit insurance (or export credit guarantee) can be useful for mitigating commercial risks, but we should pay a premium.

19 Anders Grath, at 19.
3.2 Country risk

Country risk (or political risk) means the risk attributable to the country without the responsibilities of the parties. Country risk includes war, civil disorder, country default, foreign exchange reserve running out, restriction on foreign currency exchange, restriction on foreign currency transfer, etc. Country risk also includes non-payment by public authorities or by private enterprises acting on the state's behalf. Change of political regime, government legislation or monetary policy can be a country risk. Most export credit insurances (or export credit guarantees) also cover the country risk by an exporting country. Thus, export credit insurance (or export credit guarantee) is available to protect from country risk.

The "Arrangement on Officially Supported Export Credits" of the OECD provides "the five elements" of country credit risk in Article 25:

- a general moratorium on repayments decreed by the obligor's/guarantor's government or by that agency of a country through which repayment is effected;
- political events and/or economic difficulties arising outside the country of the notifying Participant or legislative/administrative measures taken outside the country of the notifying Participant which prevent or delay the transfer of funds paid in respect of the credit;
- legal provisions adopted in the obligor's/guarantor's country declaring repayments made in local currency to be a valid discharge of the debt, notwithstanding that, as a result of fluctuations in exchange rates, such repayments, when converted into the currency of the credit, no longer cover the amount of the debt at the date of the transfer of funds;
- any other measure or decision of the government of a foreign country which prevents repayment under a credit; and
- cases of force majeure occurring outside the country of the notifying Participant, i.e., war (including civil war), expropriation, revolution, riot, civil disturbances, cyclones, floods, earthquakes, eruptions, tidal waves and nuclear accidents.

Each export credit agency (ECA) developed its own system for assessing commercial risk and country risk, and provides export credits (export credit guarantee, etc.)
3.3 Exchange risk

If the contract price is in a currency other than that in which cost incurs, exchange risk will arise. In the case the contract requires payment in the exporter's currency, the importer bears the exchange risk. In the case the contract calls for payment in the importer's currency, the exporter carries the exchange risk.

Fluctuation of the exchange rate might bring unexpected loss or profit, which is a significant risk in international business transactions. Foreign exchange risk results in actual monetary loss or damage. Foreign exchange risk management has been one of the significant concerns for most exporters, in particular, for small- and medium-sized enterprises (“SMEs”). Depreciation in the contract currency will present an exporter with unexpected loss, while appreciation in the contract currency will present an importer with unexpected loss. The volume of exchange risk depends on a particular currency and the period of payment. Soft currency will normally bring bigger risk as it fluctuates more than hard currency. Transaction with soft currency can be a problem for the other party. In some cases, the choice of currency for a contract is more important than the contract price (or unit price) itself. A movement in a foreign exchange rate creates unexpected losses or profits in a transaction.

There are various methods of hedging foreign exchange risk, but the parties to an international business transaction find many of them unacceptable or impracticable. By using forward exchange or future exchange, the parties to an international business transaction can reduce foreign exchange risk. But such an exchange hedge incurs transaction costs. Some export credit agencies operate “foreign exchange risk insurance (or foreign currency guarantee), and a foreign exchange risk insurance operated by an export credit agency has been well accepted for foreign exchange risk hedging.

25 Charles W.L. Hill, et al., at 530.
Restriction on foreign currency exchange or restriction on foreign currency transfer is taken by the government and is attributable to the government. Thus, restriction on foreign currency exchange or restriction on foreign currency transfer is a type of country risk. However, exchange risk is not directly attributable to the government, although it is, in some way, affected by the national economy and politics.